

## Internal Revenue Service

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## Department of the Treasury

Washington, DC 20224

Third Party Communication: None

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, ID No.

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Refer Reply To:

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PLR-106500-15

Date:

March 12, 2015

Settlor =

Trust =

Daughter =

Date 1 =

Date 2 =

Date 3 =

State =

a =

b =

Court =

Dear

This letter responds to a letter dated January 14, 2015, submitted on behalf of Trust, requesting rulings on the income, estate, gift and generation-skipping transfer (GST) tax consequences of the division of a trust.

### FACTS

Settlor died on Date 2, a resident of State. Section 2.1 of Settlor's will, dated Date 1, established a trust (Trust) for the benefit of Daughter and her descendants.

Section 2.1.1 of Settlor's will provides that the trustee may pay to Daughter all or part of the net income of Trust as the trustee determines to be necessary to provide for her support, comfort, maintenance and medical care. Additionally, section 2.1.1 provides that the trustee in its discretion may distribute any net income not paid to Daughter to any one or more of Daughter's issue in such shares as the trustee determines. Net income not distributed is to be accumulated and added to principal.

Section 2.1.2 of Settlor's will provides that the trustee in its discretion may make distributions of principal to Daughter to the extent the net income of Trust is insufficient to provide for Daughter's support and maintenance or to meet any emergency which may confront Daughter.

Section 2.1.3 of Settlor's will provides that the trustee in its discretion may distribute to any one or more of Daughter's children as much of the principal as the trustee determines is necessary to provide for such child's support, maintenance, education and medical care, considering his or her other income and means of support known to the trustee. Any distribution of principal made to Daughter's child under this section shall be treated as an advancement of principal to such child, and shall be charged without interest, at the value of such advancement when made, against the distributive share of such child, or of such child's issue, upon the termination of Trust.

Section 2.1.4 of Settlor's will provide that Trust terminates upon the death of Daughter. Upon termination, Trust shall distribute principal and any undistributed income to the then living issue of Daughter, per stirpes, subject to any adjustments made for advancements as provided in section 2.1.3.

Section a of State statute permits a trustee to divide a trust into two or more separate trusts if the result does not substantially impair the rights of any beneficiary or have a materially adverse effect on the achievement of the purposes of the trust. Further, section b of State statute permits a court, with the consent of the trust beneficiaries, to

modify the terms of the trust if the court concludes that modification is not inconsistent with a material purpose of the trust.

Trust, through its trustee, proposes to divide Trust's assets into two separate trusts ("Successor Trusts"); where each Successor Trust will benefit Daughter and one of Daughter's two children and the descendants of such child. The trustee proposes to effectuate this division pursuant to authority granted to it under State law and only after approval of its action by a court of competent jurisdiction in State. The trustee will allocate a 50 percent pro-rata portion of each of the assets of Trust to each of the Successor Trusts. The provisions of each Successor Trust will continue to be governed by the terms of Trust, except that so long as there is any living descendant within a particular family line, distributions of income and principal will be limited to Daughter and the descendants of that particular family line. In addition, Daughter's distributions of income or principal must come equally from both Successor Trusts. In all other respects, the Successor Trusts will be identical to Trust. It has been represented that there have not been any distributions from Trust described in section 2.1.3 of Settlor's will. It has been further represented that sufficient GST exemption has been allocated to Trust such that Trust has a zero inclusion ratio.

The trustee and beneficiaries filed a petition for modification and division of Trust with Court. On Date 3, Court issued an Order approving the modification and division effective upon the receipt of rulings, set forth below, from the Internal Revenue Service. A motion for supplemental order has been filed to make it clear that following the division of Trust into Successor Trusts, any future distributions to Daughter will be made from and charged equally to each Successor Trust.

#### RULINGS REQUESTED

1. The modification and division of Trust into Successor Trusts will not alter the inclusion ratio of Trust, and each Successor Trust will have the same inclusion ratio as Trust for GST tax purposes.
2. The modification and division of Trust into Successor Trusts will not create or result in a transfer of property subject to federal gift tax under § 2501 of the Internal Revenue Code (Code).
3. The modification and division of Trust into Successor Trusts will not cause any portion of the assets of Trust or Successor Trusts to be includible in the gross estate of any beneficiary under §§ 2035, 2036, 2037, or 2038.
4. The Successor Trusts will be treated as separate trusts for federal income tax purposes pursuant to § 643(f).
5. The modification and division of Trust into Successor Trusts will not result in treating any Trust property as paid, credited, or distributed for purposes of § 661 or § 1.661(a)-2(f) of the Income Tax Regulations, and so will not result in realization of any income, gain, or loss under §§ 661 or 662 by Trust, the Successor Trusts, or a beneficiary of any of the trusts. In addition, the

modifications and division of Trust into Successor Trusts will not result in the realization of any income, gain or loss to Trust, the Successor Trusts, or a beneficiary of any of those trusts under § 61 or § 1001.

6. The modification and division of Trust into Successor Trusts will result in each Successor Trust holding its share of Trust's property with the same basis as it had when owned by Trust at the time of the division into Successor Trusts under § 1015.

### Ruling 1

Section 2601 imposes a tax on every GST. Under § 1433(a) of the Tax Reform Act of 1986 (Act), the GST tax is generally applicable to GSTs made after October 22, 1986. However, under § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to any GST from a trust if the trust was irrevocable on September 25, 1985, and no addition (actual or constructive) was made to the trust after that date.

Under § 2602, the amount of tax imposed under § 2601 is determined by multiplying the taxable amount (the amount involved in the GST transfer) by the applicable rate. Under § 2641, the term "applicable rate" means the product of the maximum federal estate tax rate in the year that the GST occurs and the inclusion ratio. Under § 2642(a)(1), the inclusion ratio with respect to any property transferred in a GST is 1 minus the applicable fraction. Under § 2642(a)(2), in general, the numerator of the applicable fraction is the amount of GST exemption allocated to the property transferred and the denominator is the value of the property transferred.

Section 2631(a) in effect for the date of the transfer provides that for purposes of determining the inclusion ratio, every individual is allowed a GST exemption of \$1,000,000 which may be allocated by the individual or the individual's executor to any property with respect to which the individual is the transferor.

Section 26.2601-1(b)(4)(i) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the GST tax under § 26.2601-1(b) will not cause the trust to lose its exempt status. These rules are applicable only for purposes of determining whether an exempt trust retains exempt status for GST tax purposes. The rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(D) provides that a modification of the governing instrument by judicial reformation or nonjudicial reformation that is valid under applicable state law will not cause an exempt trust to be subject to the GST tax, if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation

(as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. A modification of an exempt trust will result in a shift in a beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount of a GST or the creation of a new GST.

Section 26.2601-1(b)(4)(i)(E), Example 5, provides as follows. In 1980, Grantor established an irrevocable trust for the benefit of his two children, A and B, and their issue. Under the terms of the trust, the trustee has the discretion to distribute income and principal to A, B, and their issue in such amounts as the trustee deems appropriate. On the death of the last to die of A and B, the trust principal is to be distributed to the living issue of A and B, per stirpes. In 2002, the appropriate local court approved the division of the trust into two equal trusts, one for the benefit of A and A's issue and one for the benefit of B and B's issue. The trust for A and A's issue provides that the trustee has the discretion to distribute trust income and principal to A and A's issue in such amounts as the trustee deems appropriate. On A's death, the trust principal is to be distributed equally to A's issue, per stirpes. If A dies with no living descendants, the principal will be added to the trust for B and B's issue. The trust for B and B's issue is identical (except for the beneficiaries), and terminates at B's death at which time the trust principal is to be distributed equally to B's issue, per stirpes. If B dies with no living descendants, principal will be added to the trust for A and A's issue. The division of the trust into two trusts does not shift any beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the division. In addition, the division does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. Therefore, the two partitioned trusts resulting from the division will not be subject to the provisions of chapter 13.

In the instant case, Trust became irrevocable after September 25, 1985. It is represented that sufficient GST exemption was allocated to Trust so that Trust has an inclusion ratio of zero under § 2642. No guidance has been issued concerning changes that may affect the status of trusts that are exempt from GST tax because sufficient GST exemption was allocated to the trust to result in an inclusion ratio of zero. At a minimum, a change that would not affect the GST status of a grandfathered trust should similarly not affect the exempt status of such a trust.

The proposed modification and division of Trust into Successor Trusts is similar to the facts in Example 5 of § 26.2601-1(b)(4)(i)(E). Therefore, the proposed modifications and division (i) will not result in a shift of any beneficial interest in Trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons holding the beneficial interests prior to the division, and (ii) will not extend the time for vesting of any beneficial interest beyond the period provided for under Trust. Accordingly, based upon the facts submitted and the representations made, we

conclude that the modification and division of the Trust into Successor Trusts will not alter the inclusion ratio of Trust and the Successor Trusts will each have the same inclusion ratio as Trust for GST tax purposes.

### Ruling 2

Section 2501 imposes a tax for each calendar year on the transfer of property by gift during such calendar year by any individual.

Section 2511(a) provides that the gift tax applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property transferred is real or personal, tangible or intangible.

In this case, the proposed modification and division of Trust does not increase, decrease, or otherwise change any beneficiary's beneficial interest in Trust. Accordingly, based upon the facts submitted and the representations made, the modification and division of Trust into Successor Trusts will not create or result in a transfer of property subject to federal gift tax under § 2501.

### Ruling 3

Section 2033 provides that the value of the gross estate includes the value of all property to the extent of the interest therein of the decedent at the time of his death.

Section 2035(a) provides that if (1) the decedent transferred an interest in property or relinquished a power with respect to any property, during the 3-year period ending on the date of the decedent's death, and (2) the value of the property (or interest therein) would have been included in the gross estate under §§ 2036, 2037, 2038, or 2042 if the interest or power had been retained by the decedent on the date of death, then the value of the gross estate shall include the value of any property (or interest therein) that would have been so included. Under § 2035(b), the gross estate shall be increased by the amount of any gift tax paid by the decedent or his estate on any gift made by the decedent or his spouse during the 3-year period ending on the date of the decedent's death.

Section 2036(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in the case of a bona fide sale for an adequate consideration in money or money's worth), by trust or otherwise, under which the decedent has retained for his life or for any period not ascertainable without reference to the decedent's death or for any period which does not in fact end before the decedent's death (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Section 2037(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, if (1) the possession or enjoyment thereof can, through ownership of such interest, be obtained only by surviving the decedent, and (2) the decedent has retained a reversionary interest in the property and the value of the reversionary interest immediately before the death of the decedent exceeds 5 percent of the value of the property.

Section 2038(a)(1) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of the decedent's death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished during the 3-year period ending on the date of the decedent's death.

In order for §§ 2035 through 2038 to apply, a decedent must have made a transfer of property or any interest therein (except in the case of a bona fide sale for an adequate consideration in money or money's worth) under which the decedent retained an interest in, or power over, the income or corpus of the transferred property. The beneficiaries of the Successor Trusts have the same interests after the modification and division as they had prior to the modification and division. Therefore, nothing will be transferred by them by reason of the proposed modification and division. Accordingly, based upon the facts submitted and the representations made, we conclude that the modification and division of Trust into Successor Trusts will not cause any portion of the assets of Trust or Successor Trusts to be includible in the gross estate of any beneficiary under §§ 2035, 2036, 2037 or 2038.

#### Ruling 4

Section 643(f) provides that, for purposes of subchapter J of chapter 1 of subtitle A, under regulations prescribed by the Secretary, two or more trusts shall be treated as one trust if (1) such trusts have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries, and (2) a principal purpose of such trusts is the avoidance of the tax imposed by chapter 1.

Section 1806(b) of the Tax Reform Act of 1986 provides that § 643(f) shall apply to taxable years beginning after March 1, 1984; except that, in the case of a trust that was

irrevocable on March 1, 1984, it shall apply only to that portion of the trust that is attributable to contributions of corpus after March 1, 1984.

Successor Trusts will each have different primary beneficiaries. We conclude that as long as each Successor Trust created by the division of Trust is separately managed and administered, they will be treated as separate trusts for federal income tax purposes.

#### Ruling 5

Section 61(a) defines gross income as all income from whatever source derived.

Section 61(a)(3) provides that gross income includes gains derived from dealings in property.

Section 661(a) provides that in any taxable year a deduction is allowed in computing the taxable income of a trust (other than a trust to which subpart B applies), for the sum of (1) the amount of income for such taxable year required to be distributed currently; and (2) any other amounts properly paid or credited or required to be distributed for such taxable year.

Section 1.661(a)-2(f) of the Income Tax Regulations provides that gain or loss is realized by the trust or estate (or the other beneficiaries) by reason of a distribution of property in kind if the distribution is in satisfaction of a right to receive a distribution of a specific dollar amount, of specific property other than that distributed, or of income as defined under § 643(b) and the applicable regulations, if income is required to be distributed currently.

Section 662 provides that there shall be included in the gross income of a beneficiary to whom an amount specified in § 661(a) is paid, credited, or required to be distributed (by an estate or trust described in § 661), the sum of the following amounts: (1) the amount of income for the taxable year required to be distributed currently to such beneficiary, whether distributed or not; and (2) all other amounts properly paid, credited, or required to be distributed to such beneficiary for the taxable year.

Section 1001(a) provides that the gain from the sale or other disposition of property is the excess of the amount realized over the adjusted basis provided in § 1011 for determining gain, and the loss is the excess of the adjusted basis provided in § 1011 for determining loss over the amount realized.

Section 1001(b) defines the amount realized from the sale or disposition of property as the sum of any money received plus the fair market value of any property received.



Section 1001(c) provides that, except as otherwise provided in subtitle A, the entire amount of gain or loss determined under § 1001 on the sale or exchange of property must be recognized.

Section 1.1001-1(a) provides that, except as provided in subtitle A, the gain or loss realized from the exchange of property for cash or for other property differing materially either in kind or in extent is treated as income or loss sustained.

An exchange of property results in the realization of gain under § 1001 if the properties exchanged are materially different. Cottage Savings Association v. Commissioner, 499 U.S. 554 (1991). There is a material difference when the exchanged properties embody legal entitlement “different in kind or extent” or if they confer “different rights and powers.” 499 U.S. at 565.

Rev. Rul. 56-437, 1956-2 C.B. 507, holds that a partition of jointly owned property is not a sale or other disposition of property where the co-owners of the property sever their joint interests in order to extinguish their survivorship interests.

Trustee will divide Trust by allocating a pro rata portion of each and every asset of Trust to the two Successor Trusts. Since the trust beneficiaries will hold essentially the same interests before and after the division of Trust into the Successor Trusts, there will be no exchange of property interests that can be characterized as materially different under § 1001, nor any amount includible in gross income under § 61.

Moreover, § 1.1001-1(h) provides that the pro rata division (or severance) of any trust pursuant to authority in an applicable state statute is not an exchange of property differing materially either in kind or extent. In this case, section a of State statute permits such division of Trust.

Therefore, based on the facts submitted and representations made, we conclude that the division of Trust into two separate trusts is not a distribution under § 661 or § 1.661(a)-2(f). We further conclude that the proposed division of Trust’s assets among the two new trusts will not cause Trust, the two new trusts, or the beneficiaries to recognize any income, gain, or loss under §§ 61, 662, and 1001.

#### Ruling 6

Section 1015(a) provides that if the property was acquired by gift, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift, except that if the basis (adjusted for the period before the date of the gift as provided in § 1016) is greater than the fair market value of the property at the time of the gift then for the purpose of determining loss the basis shall be the fair market value.

Section 1.1015-2(a)(1) provides that in the case of property acquired after December 31, 1920, by transfer in trust (other than by a transfer in trust by gift, bequest, or devise) the basis of property so acquired is the same as it would be in the hands of the grantor increased in the amount of gain or decreased in the amount of loss recognized to the grantor on the transfer under the law applicable to the year in which the transfer was made. If the taxpayer acquired the property by a transfer in trust, the basis applies whether the property be in the hands of the trustee, or the beneficiary, and whether acquired prior to the termination of the trust and distribution of the property, or thereafter.

Based on the facts submitted and representations made, we conclude that because § 1001 does not apply to the division of the trust assets, under § 1015 the basis of the trust assets will be the same after the modification and division of Trust as the basis of those assets before the modification and division.

This ruling is directed only to the taxpayers requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to Trust's authorized representative.

Sincerely,

Faith P. Colson

Faith P. Colson  
Senior Counsel, Branch 1  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2)  
Copy of this letter  
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